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No. 778

Supreme Court of the United States

October Term, 1967

BALTIMORE AND OHIO RAILROAD COMPANY, et al.,

Appellants

v.

UNITED STATES OF AMERICA, et al.,

Appellees

On Appeal from the United States District Court for the Southern District of New York

BRIEF OF APPELLANTS IN OPPOSITION TO MOTIONS TO AFFIRM

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TABLE OF CONTENTS

PAGE

1. The Commission Has Failed To Preserve The Essential Services Of The Protected Roads, Not Because It Lacked Power To Compel Inclusion, But Because It Imposed The Appendix G Conditions 4

2. Appellees' Other Contentions Do Not Justify Immediate Consummation Of The Penn-Central Merger 10

CONCLUSION 14

AUTHORITIES

PAGE

Statute:

Interstate Commerce Act, 49 U.S.C.:
Section 5 4

Miscellaneous:

N.Y. Times, November 9, 1967 12

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The motions to affirm filed by the various appellees have brought the central controversy in this case into sharp focus. Thus, the principal appellees—the United States and the Commission itself—now appear to concede that if the *Inclusion* order is set aside, the Penn-Central merger cannot be consummated, since "an appropriate haven" will not have been found for the three protected railroads (U.S. Mo. Aff., p. 22). Hence, the only substantial issue which now separates the parties to this case is whether the merger can be consummated if the *Inclusion* order is affirmed. Appellees' motions to affirm confirm the soundness of our position that, even on that assumption, the merger cannot now be consummated.

Throughout these proceedings, the basic problem facing the Commission has been to find a way in which it could condition the merger of the two largest railroads in the East so as to permit consummation of the merger without threatening the ability of other Eastern railroads to provide vital transportation service. In its original report, the Commission found that the essential transportation services of EL, D&H and B&M must be preserved, and that their services could not be preserved if these railroads remained independent following consummation of the Penn-Central merger (327 I.C.C. at 529, 532). The Commission originally found that it could not absolutely guarantee that each of these railroads would be included in a major system, but it nonetheless would have permitted immediate consummation of the merger on the hope and expectation that EL, D&H and B&M could be taken care of later (328 I.C.C. at 312).[1] When the Commission's approach was attacked upon judicial review, this Court rejected the idea that the task of guaranteeing the essential services of EL, D&H and B&M could be deferred until after the consummation of the merger. Instead, it held that these services must be preserved through the inclusion of those roads in a major system before the merger was consummated (386 U.S. at 378, 390).

Upon remand, the Commission decided the *Inclusion* case on the stated assumption that its order would fulfill

[1]The New Haven Trustees appear to rely upon the fact that the Commission in September of 1966 "recognized" that the protected roads might not be included in a major system (New Haven Trustees' Mo. Aff., pp. 14-15). But this Court reversed that order precisely because no determination had been made as to the inclusion of these roads "in a major system . . . prior to consummation of the Penn-Central merger" (386 U.S. at 390).

this purpose (330 I.C.C. at 329, 350, 355). Yet, as we have shown both in our Jurisdictional Statement and in the briefs filed in the district court, the *Inclusion* order does not determine the ultimate fate of all three of these railroads, since at least one, and possibly two of them will not accept the terms of that order. In these circumstances, neither the Commission's basic finding nor this Court's mandate has been satisfied, for the ultimate fate of any railroad remaining outside of N&W obviously has not been determined and nothing whatever has been done to assure preservation of the essential services of such a railroad.

The most significant aspect of the appellees' motions to affirm is that each of them virtually admits these errors in the Commission's order. Appellees concede, as they must, the "possibility" that "of the three smaller roads offered inclusion in the N&W system . . . one, and perhaps two, may decline the offer" (U.S. Mo. Aff., p. 16). They also recognize that, if this should happen, "the mere *offer* of inclusion does not settle the 'fate' of the affected roads" (*id.*, at p. 22), for the Commission would still be forced to find a home for them from among the several possible alternatives to N&W inclusion which exist, one of which is inclusion in the Penn-Central system.

Thus the questions now before the Court all arise from this now-conceded fact that despite the holding of this Court that the ultimate fate of EL, D&H and B&M was to be determined prior to the merger, one or more of those railroads will, under the Commission's order, still

be looking for a home after the merger has been consummated.

1. The Commission Has Failed To Preserve The Essential Services Of The Protected Roads, Not Because It Lacked Power To Compel Inclusion, But Because It Imposed The Appendix G Conditions.

Although certain of the appellees attempt to cloud the issue by re-arguing the merits of the case decided by this Court last term, the mandate of this Court has not been observed. Indeed, this fact emerges with unmistakable clarity from the Government's own motion to affirm.

The Government does not even attempt to explain how the admitted necessity for a *future* determination of the appropriate fate of one or more of the protected railroads can be squared with the plain language of this Court's decision which required the determination of the ultimate fate of those roads *before* the merger is consummated. Nor does it explain how the essential services of such a railroad will be preserved while this determination is being made. Instead, the Government devotes itself principally to a discussion of the limitations upon the power of the Commission under Section 5 of Interstate Commerce Act (49 U.S.C. § 5), pointing out that under that section "the Commission can only determine whether, and upon what conditions, carrier-initiated proposals for merger or inclusion will be in the public interest" and that it "cannot order the beneficiaries of the order to accept the proffered home" (U.S. Mo. Aff., p. 23). The Government argues, in effect, that the Commission has done everything that

it had the power to do, and that the opinion of this Court should not be interpreted to require anything more.

Throughout all of this argument, the Government fails to recognize that the decision of this Court was designed to protect, not the private interests of the stockholders of EL, D&H and B&M, but the public interest in preserving the essential services of those railroads. Thus, the Government interprets this Court's decision as not requiring the Commission "to do more than offer the *potential victims* of the merger a safe haven on equitable terms" whether or not "the *beneficiaries* of the order . . . accept the proffered home" (*ibid.*). (Emphasis added.)

The error in the Government's approach is that it ignores the fact that the "potential victims" of the merger and the "beneficiaries" of the Commission's order are two separate groups with widely disparate interests. The "potential victims" of the Penn-Central merger under the Commission's own basic finding are the members of the public who must depend upon the essential transportation services of EL, D&H and B&M. The "beneficiaries" of the Commission's *Inclusion* order are not those "potential victims," but instead are the stockholders of the three railroads.

Seeking to make it appear that the interests of these two groups coincide, the Government supports the order of the Commission because "now, all three roads are content to allow consummation to proceed" (U.S. Mo. Aff., p. 23). In the ordinary case this approach might have merit, since normally a stockholder cannot

realize a profit on his investment unless his railroad provides service for which the public is willing to pay. However, the Commission's order in this case has destroyed this normal coincidence of interest between the public and the stockholders of EL, D&H and B&M. Under the Commission's order, with the unique revenue-sharing provisions of Appendix G, the stockholders of EL, D&H and B&M may realize handsome profits even if the services of those railroads deteriorate to the point where they are of no use at all to the public.

The Commission has *not* done all it could to preserve the essential services of D&H and B&M, as required by this Court's mandate. The totality of the Commission's efforts to preserve the essential services of these railroads amounts to nothing more than offering them a home in N&W, on the one hand, while removing the incentive for them to accept that home on the other.[2] In fact, by leaving open to D&H and B&M the possibility of inclusion in Penn-Central, the Commission has created an affirmative incentive for those railroads to reject inclusion in N&W, since they are now free to seek a higher price from Penn-Central while the stockholders of these railroads enjoy complete protection under Appendix G.

As a practical matter, the question of the extent of the Commission's power under Section 5 would not have

[2]The fact that EL's shareholders have nevertheless accepted the terms of the *Inclusion* order serves to emphasize the complete lack of correlation between the inflated terms offered to EL and EL's plummeting earnings. N&W contends that the terms offered all three railroads are excessive, but the disparity between EL's "normal" earnings of $9.5 million as found by the Commission and its reported current deficit of $10 million is especially extreme (See N&W's Brief in Opposition in No. 779).

become relevant here at all if the Commission had not imposed, *sua sponte*, the Appendix G conditions, and thereby separated the interests of the shipping public from those of shareholders of the protected roads. Without the financial protection of Appendix G, no railroad faced with destruction by Penn-Central could even have contemplated the course now being pursued by B&M, and perhaps D&H. The real question in this case, therefore, is not whether the Commission is powerless to prevent "a rash gamble" by the stockholders of any railroad (U.S. Mo. Aff., pp. 25-26), but whether it ought to have created a situation in which the stockholders take no gamble even if Penn-Central destroys their railroad's ability to provide essential service. It is the Commission's unsupportable exercise of power, not its lack of power, that is at issue here.

We submit that the Commission's action in permitting such a riskless "gamble" is clear error. If the Commission's decision in the *Inclusion* case that the protected railroads should be included in N&W is sound, then such inclusion obviously should occur as soon as possible. What then is the purpose of the protective conditions? When Appendix G was originally injected into this case by the Commission in 1966, before the hearings in the *Inclusion* case had even begun, its purpose was to afford protection during an interim between consummation of the merger and determination of inclusion. But as this Court recognized in its previous opinion, such protection will be unnecessary if the *Inclusion* case has actually determined the ultimate fate of the protected

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roads, since there would be no such interim (386 U.S. at 390):

> "In view of the patent invalidity of the order permitting immediate consummation of the merger and in light of the present status of the litigation before the Commission, we can only conclude that it is necessary that the decision as to the future of the protected railroads and their inclusion in a major system be decided prior to consummation of the Penn-Central merger. . . . Furthermore, there would be no occasion for the conditions of Appendix G being imposed and hearing and decision on this highly controversial matter would not be necessary insofar as the three protected railroads are concerned."

When the Commission reimposed the Appendix G conditions after it had decided the *Inclusion* case, it failed to recognize that the purpose it had previously relied upon to impose those conditions had ceased to exist. It also ignored the impact which its order would certainly have upon both the other railroads in the East and the public interest in balanced rail competition in that area. As pointed out in our Jurisdictional Statement (pp. 19-26) and in the briefs filed in the district court, no one can deny, and the United States has explicitly recognized, that if one or more of the protected railroads is made the beneficiary of Appendix G conditions on an indefinite or permanent basis, that railroad inherently becomes an ally of Penn-Central, and such an alliance is just as certain to cause harm to every other railroad in the East and to the public interest in balanced rail com-

petition.[3] Although some of the appellees seek to avoid this fact, none of them denies that it is established by the Commission's own finding, adopted from the report of its Examiners.

The Commission's Examiners expressly found that the Penn-Central merger would "undoubtedly result in a shifting of traffic patterns," but that the "net effect will not be detrimental" to the other Eastern railroads because they would enter into "new traffic relationships" (Recommended Report in F.D. 21989-21990, p. 305). Although the Commission adopted this finding as its own (327 I.C.C. at 481), it has now created a situation through the indemnity provisions of Appendix G in which at least one, and perhaps two, of the protected lines will be led, not to cooperate with other Eastern railroads to minimize the effect of Penn-Central, but to cooperate with Penn-Central itself. This can only increase the threat already inherent in that system to the railroads that must compete with it.

The failure of the Commission's order of June 9, 1967, to satisfy the mandate of this Court cannot be excused. The Commission should be compelled to deter-

[3] B&M attempts in its motion to affirm (p. 9) to convey the impression that N&W has stated that it would not be harmed if D&H and B&M were included in Penn-Central while EL were included in N&W. This is a misuse of the statement of counsel, who quite obviously was talking only of the N&W, and referring to the fact that as a predominantly coal-carrying road not operating east of Buffalo, N&W would prefer to suffer the harm from having D&H and B&M included in Penn-Central than to be required to acquire those two roads with which N&W does not even connect. Counsel plainly did not mean to indicate that EL would not be affected by the inclusion of D&H and B&M, in view of the economic "interdependence" of EL, D&H and B&M (330 I.C.C. at 798, 832). If N&W is to be compelled to include EL, it would be seriously harmed, as the owner of EL, by inclusion of D&H and B&M in Penn-Central.

mine the ultimate fate of D&H and B&M before consummation of the Penn-Central merger, as this Court held that it should, and the provisions of the Commission's order which tend only to frustrate such a determination should be set aside.

2. Appellees' Other Contentions Do Not Justify Immediate Consummation Of The Penn-Central Merger.

Penn and Central devote considerable space in their motion to affirm to an effort to demonstrate that these appellants are not injured by the Appendix G conditions, that the Penn-Central merger will provide substantial benefits to the public notwithstanding those conditions, and that, beyond these benefits, immediate consummation of the merger is justified as a means of saving the New Haven. Each of these matters is covered at length in our Jurisdictional Statement, as well as in the briefs filed in the district court. It is appropriate, however, simply to restate succinctly our position on each one of these matters:

(1) The Commission erroneously relied upon the assumption that all three of the protected railroads would accept the Inclusion order when it held that Appendix G could not harm the unprotected railroads since it would be in effect only a relatively short period of time during which the protected roads would expect to become affiliates of N&W. Penn and Central (P-C Mo. Aff., pp. 9-12), concede that the Commission relied upon these grounds but argue that there are also "substantial grounds

entirely independent of any question of the expectation of the protected lines as to their future" (P-C Mo. Aff., p. 10). The question presented to the Court is whether the Commission's reliance upon grounds now shown to be contrary to fact can be disregarded and grounds not relied on by the Commission can be substituted. This would be a plain violation of the *Chenery* rule (J.S., pp. 15-19).

(2) There is neither evidence in the record nor findings in the Commission's report to support the district court's belief that Penn-Central could achieve substantial savings despite Appendix G (J.S. at B15) or the argument, advanced by Penn and Central after the record in the case had been closed, that merger projects could or would be started before a definite end of the protective period was in sight.

Again, only Penn and Central even discuss this point (P-C Mo. Aff., pp. 12-16). They implicitly concede that there is no specific evidence to support a finding of savings in the record, and the only Commission finding on the subject to which they point is a statement by the Commission that "the public interest requires that the applicants be permitted to commence achieving the substantial savings which the merger will make possible at the earliest possible date" (330 I.C.C. at p. 361, quoted at P-C Mo. Aff., p. 15), which is not a finding that benefits can ever be achieved under Appendix G. The question for the Court to decide here is whether the record must contain evidence and findings that merger benefits can be realized under the conditions attached to that merger.

(3) It would be contrary to the public interest to permit Penn and Central to buy the right to consum-

mate their merger by offering to loan money to the New Haven, in view of the harm which would be occasioned to other railroads. The eleventh-hour arrival of the Commission's November 21 order in the *New Haven* proceedings comes as no surprise. Nor does it change the fact that the principal appellees now attempt to justify consummation of the Penn-Central merger on the ground that those two railroads are willing to lend the New Haven some badly needed money.

The Commission's latest order does not achieve the inclusion of the New Haven into Penn-Central. It merely sets terms, subject to approval by the reorganization court, which if approved will not be carried out for at least another year.

If the New Haven needs funds by January 1, 1968, to maintain its services, and if the public interest demands that these services be maintained, there is every reason to believe that public funds can and will be found. The States have been contributing to the support of the New Haven for some years, and if wage increases have aggravated the New Haven's need for funds, there is no reason to believe that the States will not make the additional contribution to meet the additional need.[4] If the States concerned do not see fit to continue their subsidization, they can loan funds to aid the New Haven through this interim period through participation in trustees' certificates.

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[4]On November 7, 1967, the voters of New York approved a $2.5 billion bond issue to meet the transportation needs of the State, including the need for funds to support rail commuter services (*N. Y. Times*, November 9, 1967, p. 1, col. 6).

However, even if Penn and Central should enter into a loan arrangement with the New Haven, this in no way requires consummation of their merger by January 1. Their assertion that this money can only be lent if "prompt consummation of the Penn-Central merger" occurs (P-C Mo. Aff., p. 19) is a bald effort to buy their merger at the expense of the other railroads in the East. Penn and Central can loan money to New Haven without any guarantee that their merger will be consummated by January 1, and without prejudice to their sharing in New Haven losses at such time as consummation of their merger is authorized consistent with the mandate of this Court.

Conclusion

For the foregoing reasons, the order of the Commission in the Penn-Central merger case should be set aside.

Respectfully submitted,

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